**Before the**
**COPYRIGHT ROYALTY JUDGES**
**LIBRARY OF CONGRESS**
**Washington, D.C.**

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| In the Matter of<br><br>Mechanical and Digital Phonorecord Delivery Rate Adjustment Proceeding | Docket No. 2006-3 CRB DPRA |

# PROPOSED CONCLUSIONS OF LAW OF THE DIGITAL MEDIA ASSOCIATION ("DiMA") AND ITS MEMBER COMPANIES AOL, LLC; APPLE INC.; MEDIANET DIGITAL, INC.; AND REALNETWORKS, INC.

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Pursuant to section 351.14 of the rules of the Copyright Royalty Judges (the "Court"), 37 C.F.R. § 351.14, and the Court's Scheduling Order of November 20, 2007, the Digital Media Association ("DiMA"),[1] joined by AOL, LLC; Apple Inc. (f/k/a "Apple Computer, Inc."); MediaNet Digital, Inc. (f/k/a "MusicNet, Inc."); and RealNetworks, Inc., who have each filed individual notices of participation in this proceeding,[2] submit the following Proposed Conclusions of Law in support of requested rates and terms (attached hereto at Tab A) for the compulsory license to make and distribute phonorecords by means of a digital transmission constituting a digital phonorecord delivery ("DPD") pursuant to 15 U.S.C. § 115.

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[1] Established in 1998, DiMA is a national trade organization devoted primarily to the online audio and video industries, and more generally to commercially innovative digital media opportunities.

[2] Napster, LLC and Yahoo!, Inc. each filed individual notices of participation and joined DiMA's Written Direct Testimony but have since withdrawn from the proceeding.

## INTRODUCTION

1. The purpose of this proceeding is to set royalty rates and terms for the statutory license to reproduce and distribute phonorecords, including by digital phonorecord transmission. 17 U.S.C. § 115(c). This Court must set these rates and terms to achieve the statutory objectives set forth at 17 U.S.C. § 801(b)(1) in a marketplace that is undergoing rapid, irreversible, and seismic change. DiMA PFF §§ III; VIII; X. DiMA proposes a percentage rate that achieves the statutory objectives in line with the most useful comparators. The National Music Publishers' Association, Inc., the Songwriters Guild of America and the Nashville Songwriters Association International ("Copyright Owners") want a higher penny rate to make up for plummeting song sales.

2. No one disputes the impact of rampant Internet-based piracy in the marketplace. DiMA PFF § III(A). The result is dramatic reduction in the sale of recorded music in all formats and intense downward pressure on retail prices – along with a brutally difficult competitive environment. DiMA PFF §§ III(A); V(A), (D). All sides agree on the importance of ensuring that consumers purchase royalty-bearing works, providing a return to copyright owners and income to copyright users. DiMA PFF § IV. Consequently, the need for technological innovation, investment and risk-taking to expand the market for music sales, bring in new digital distributors, and offer new outlets for creative expression has never been higher. DiMA PFF §§ IV; V; X.

3. The statutory license to make and distribute phonorecords dates back to the early 20th Century – a different era whose cutting edge musical "technology" (the player piano) now seems quaint. Nevertheless, Congress was sufficiently motivated by concerns about the potential anti-competitive consequences of allowing copyright owners

to impede the development of new technologies to bring music to the public that it saw fit to adopt conditions requiring the licensing of musical works. H.R. Rep. No. 2222, 60th Cong., 2d Sess. 7 (1909) (referencing concerns about a "music monopoly"). *See also Adjustment of Royalty Payable Under Compulsory License for Making and Distributing Phonorecords*, 46 Fed. Reg. 10466, 10483 (Feb. 3, 1981) (the statutory license was enacted to "guarantee[]" licensees "full access to copyright[ed] music."). Thus, the roots of the license itself derive from Congress's intention to ensure the availability of competitively priced music to the marketplace. To accomplish this, the "statutory rate . . . regulates the price of music." 46 Fed. Reg. 10466, 10480. For nearly 100 years, Congress has steadfastly kept this safeguard in place.

4. After a long period where the rates for the mechanical license were set in statute, Congress delegated the authority and enumerated the objectives that must be achieved as follows:

> (A) To maximize the availability of creative works to the public.
>
> (B) To afford the copyright owner a fair return for his or her creative work and the copyright user a fair income under existing economic conditions.
>
> (C) To reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication.
>
> (D) To minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.

17 U.S.C. § 801(b)(1)(A)-(D). The objectives are comprehensive. They are not piecemeal suggestions but a specifically articulated framework. *See Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, 73 Fed. Reg. 4080, 4094 (Jan. 24, 2008); *accord Determination of Reasonable*

*Rates and Terms for the Digital Performance of Sound Recordings*, 63 Fed. Reg. 25394 (May 8, 1998); 46 Fed. Reg. 10466 (Feb. 3, 1981). While they demand no particular approach or specific formula, they are clearly intended to guide the entire ratesetting process.

5. As the plain language of the statute makes clear, Congress did not authorize ratesetting in this proceeding to achieve an outcome that merely replicates – or makes minor adjustments to – the outcome of an otherwise unregulated marketplace. The D.C. Circuit put it clearly when it most recently had occasion to review a ratesetting decision under section 801(b)(1): "the term 'reasonable copyright royalty rates' . . . takes its meaning from the[se] four statutory objectives . . . ." *Recording Indus. Ass'n of Am. v. Librarian of Congress*, 176 F.3d 528, 532 (D.C. Cir. 1999) ("*RIAA II*") (emphasis supplied). Not only is it "simply wrong" to claim that section 801(b)(1) "requires the use of 'market rates,'" but the D.C. Circuit specifically rejected the argument that ratesetting begins by "determin[ing] the range of market rates" against which the statutory objectives are then applied. *Id.* at 532-33 (emphasis in original). In fact, the opposite is true. *Accord* 73 Fed. Reg. 4080, 4084 (recognizing D.C. Circuit's rejection of RIAA's argument that "market rates [must be] the starting point for application of" the statutory objectives).

6. Clearly, ratesetting is "much less a science than an art." *National Ass'n of Securities Dealers, Inc. v. SEC*, 801 F.2d 1415, 1419 (D.C. Cir. 1986) (*citing Alabama Electric Coop., Inc. v. FERC*, 684 F.2d 20, 27 (D.C. Cir. 1982)). As one court has noted:

> [n]o one who seeks fairly and equitably to determine a complicated rate structure ought to suppose that there is a correct answer, or even that in the final mix there should have been added a specified number of spoonfuls of each of the ingredients. A conscientious, competent rate-making body proceeds by opening its mind to relevant considerations, and closing its ears to irrelevant ones.

*Newsweek, Inc., v. United States Postal Service*, 663 F.2d 1186, 1200 (2d Cir. 1981) (quoting *Association of American Publishers, Inc., v. Governors of United States Postal Service*, 485 F.2d 768, 774-74 (D.C. Cir. 1973)). Indeed, there is no "pretense that [ratesetting] rulings rest on precise mathematical calculations." *National Cable Television Association v. Copyright Royalty Tribunal*, 724 F.2d 176, 182 (D.C. Cir. 1983).

7. The parties in this proceeding do not pretend to offer a formula for how to set a rate, but they take very different approaches to the task entrusted to the Court. DiMA follows the language of the statute and offers comprehensive evidence to support the setting of rates for digital phonorecord deliveries as a percentage of the licensee's retail revenues, with minimum fees to provide protection for copyright owners, but without onerous terms and conditions. DiMA PFF §§ VII(A); VIII(A); X. The statutory objectives lead to a rate that will grow the market for all participants.

8. DiMA's proposal is consistent with the most relevant benchmark, which is the recent marketplace license agreement at roughly 8% of retail revenue between many of the same parties covering the same rights in the United Kingdom. DiMA PFF § IX(B). It is also informed by the outcome reached by the Copyright Royalty Tribunal when it set the statutory license rate at the equivalent of about 5% of retail revenue in 1981, an outcome affirmed by the D.C. Circuit and twice ratified through the conduct of market participants – until the dawning of the seismic changes wrought by Internet piracy. *See*

*Recording Indus. Ass'n of America v. Copyright Royalty Tribunal*, 662 F.2d 1 (D.C. Cir. 1981) ("*RIAA*"); DiMA PFF § IX(D).

9. In stark contrast, the Copyright Owners disregard the language of the statute and proceed as if there were no regulation whatsoever. DiMA PFF § VIII(B). They ignore the statutory objectives and the goal of growing the music market, focusing instead on getting the biggest possible relative piece of the royalty pie. *Id.* They interpret the statutory objectives either (i) to replicate an unregulated marketplace (which is the same as saying they do not exist) or (ii) to set rates high enough to provide incentives for private transactions (which is the same as saying the statutory license should not be a practical alternative). DiMA PFF § VII(B)(6); IX(E). Obviously it is in their interest to minimize the role of regulation in this marketplace. But there is no lawful basis for doing so. Indeed, their request lacks support in the record.

10. Certainly, the task for the Court is not easy. The record is voluminous. The statute does not provide precise instructions. But the unanimous view of the parties as to the desperate situation of the marketplace provides a singular insight. Everything must be done to grow the music market so all parties benefit. Setting a rate that achieves the objectives of section 801(b)(1) under these circumstances is not only possible – it follows directly from the evidence in the record. Maximizing the availability of creative works, recognizing how best to ensure compensation to all participants under current economic conditions, reflecting innovation and investment and risk-taking and creativity, and minimizing disruption – they can be reconciled best in an environment that promotes digital music distribution. That is what DiMA proposes.

"complex licensing scheme" legal music services have nearly insurmountable "transactions costs").

13. In 1995, Congress amended the section 115 "mechanical" license to make clear that it covered the making of digital phonorecord deliveries (so-called "DPDs"). *See* The Digital Performance Right In Sound Recording Act of 1995, Pub. L. 104-39, 109 Stat. 336 (1995) ("DPRA"). In addition, for the first time in the history of the Copyright Act, the 1995 amendments regulated certain forms of discounting from the statutory rate (so-called "controlled composition clauses") in the context of digital phonorecord deliveries. *See* 17 U.S.C. § 115(c)(3)(E).

14. The Senate Report accompanying the legislation stated that the "intention in extending the mechanical compulsory license to digital phonorecord deliveries" was:

> to maintain and reaffirm the mechanical rights of songwriters and music publishers as new technologies permit phonorecords to be delivered by wire or over the airwaves rather than by the traditional making and distribution of records, cassettes and CD's.

S. Rep. 104-128, at 37 (Aug. 4, 1995). Congress clearly sought to facilitate and enable all forms of "new technologies" that deliver phonorecords to consumers to flourish.

15. For this reason in particular, the rates and terms set here are for a license that provides the right to create all copies necessary to achieve actual delivery of the work. Otherwise, the license would not afford any meaningful rights and it would be impossible to deliver phonorecords digitally as Congress intended. *See* DiMA PFF § VIII(A)(3). Moreover, the rates and terms must be calculated to achieve the statutory objectives for an entire industry (including future entrants), not merely existing or specific licensees. *See* 17 U.S.C. § 115(1)(1) ("any . . . person . . . may . . . obtain a compulsory license to make and distribute phonorecords . . . ."). This is a particularly

important difference between this proceeding and the recent determination of rates and terms for satellite digital audio services, which set rates applicable solely to a limited class of licensees. *See, e.g.*, 17 U.S.C. § 114(j)(10) (defining "preexisting satellite digital audio radio service").

## II. RATES MUST ACHIEVE SPECIFIC STATUTORY OBJECTIVES NOT MERELY REPLICATE A MARKETPLACE RESULT

16. Section 801 of the Copyright Act, 17 U.S.C. § 801(b)(1), requires the Copyright Royalty Judges "[t]o make determinations and adjustments of reasonable terms and rates of royalty payments" as provided *inter alia* in section 115 of the Act. *See* 17 U.S.C. § 803(a)(1) (Copyright Royalty Judges "shall act in accordance with . . . prior determinations and interpretations of the Copyright Royalty Tribunal, Librarian of Congress . . . and decisions of the court of appeals under this chapter . . . ."). Under section 801(b)(1), rates must be "calculated to achieve" specific objectives. 17 U.S.C. § 801(b)(1)(A)-(D). The "natural reading" of the statutory language is that the rate must be "calculated" in the sense of being "designed or adapted for the achievement" of the statutory objectives, and not necessarily "the result of a rigorous mathematical derivation." 662 F.2d at 8, n.19.

17. Nothing in the statute suggests that the four objectives are discretionary or that any objective or element of an objective can be disregarded. *See* 17 U.S.C. § 801(b)(1) (rates "shall . . . achieve" the objectives). The statute does not elevate marketplace outcomes to any particular important role, whether as benchmarks or otherwise. And the statute does not impose any burden on the parties to present any specific quantum of evidence with regard to the objectives or to present formulae for computing or adjusting rates. *See* 46 Fed. Reg. 10466, 10478 ("no party . . . required to

sustain any general or specific burden of proof."). When the terms of the statute are unambiguous, "judicial inquiry is complete . . . ." *Rubin v. United States*, 449 U.S. 424, 430 (1981).

18. In the most recent Court of Appeals decision reviewing a ratesetting determination under the Copyright Act, the D.C. Circuit agreed with the Librarian of Congress that "the term 'reasonable copyright royalty rates' under § 801(b)(1) takes its meaning from the[se] four statutory objectives . . . ." *RIAA II*, 176 F.3d at 532. "In other words, 'reasonable rates' are simply those that are calculated to achieve the four objectives." *Id.* This conclusion was "not only permissible," but "the most natural reading of the statue." *Id.* at 533. The claim that section 801(b)(1) "requires the use of 'market rates' is simply wrong." *RIAA II*, 176 F.3d at 533 (emphasis in original).

19. Indeed, the court specifically rejected the argument that ratesetting begins by "determin[ing] the range of market rates" against which the statutory objectives are then applied. *RIAA II*, 176 F.3d at 532-33. This is consistent with prior application of the statutory objectives. In *Amusement & Music Operators Association v. Copyright Royalty Tribunal*, 676 F.2d 1144, 1157 (7th Cir. 1982), the court upheld a decision that "carefully weighed . . . marketplace analogies and other evidence specifically in light of the four statutory criteria of section 801(b)." (emphasis supplied).

20. Likewise, in *Recording Indus. Ass'n of America v. Copyright Royalty Tribunal*, 662 F.2d 1, 9 (D.C. Cir. 1981) ("*RIAA*"), the court noted that "the statutory objectives" – not marketplace benchmarks – determine the range of reasonable rates from which to determine the end result. On this basis, the Tribunal's decision was affirmed. *See RIAA II*, 176 F.3d at 534. *See also* 662 F.2d at 9 (statutory objectives determine the

range of reasonable rates); 63 Fed. Reg. at 25406 (so long as "zone" is calculated to achieve the objectives, rates may be chosen at the low end of the zone).

21. Importantly, the court in *RIAA II* pointed out that where Congress sought to require the use or attainment of market rates in the Act, it knows how to do so. Specifically, Congress "use[s] the term 'market rate' or its equivalent." *RIAA II*, 176 F.3d at 533. For example, in amending §114(f)(2), Congress directed the Librarian to "'establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller' for the new categories of services." *Id.*, quoting Pub. L. No. 105-304, 112 Stat. 2896 (codified as 17 U.S.C. §114(f)(2)(B)). Because similar language was not included in the contemporaneous revisions of subsection 114(f)(1) – governing preexisting services and applying section 801(b)(1) – the court suggested that Congress did not intend to mandate market rates for those services. *RIAA*, 176 F.3d 528. *See also id.* at 533 ("The statute does not use the term 'market rates,' nor does it require that the term 'reasonable rates' be defined as market rates"). *Accord Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings,* 63 Fed. Reg. 25394, 25399 (May 8, 1998) (the standard for setting rates under section 801(b) "is not fair market value").

22. The *RIAA II* court's argument applies with equal force to the rate determinations under section 115 at issue here. Like section 114(f)(1), section 115 contains no reference to market rates. Instead, subsection 115(c)(3)(D) closely parallels subsection 114(f)(1)(B), the provision at issue in the *RIAA II* case. While both subsections provide that "the Copyright Royalty Judges may consider the rates and terms . . . under voluntary license agreements" entered into pursuant to the respective sections,

in contrast to section 114(f)(2) they stop far short of mandating market rates. The statute clearly requires that rates be calculated to achieve the policy objectives set forth in the statute. Guidance drawn from sources other than marketplace transactions is clearly permitted and expected, to the extent that it advances the statutory objectives.

23. Indeed, the D.C. Circuit wrote in *RIAA II* that in *Recording Indus. Ass'n of America v. Copyright Royalty Tribunal*, 662 F.2d 1 (D.C. Cir. 1981) ("*RIAA*"), it had upheld the Copyright Royalty Tribunal's rate determination under section 115 "specifically because the Tribunal had followed the statutory objectives," and that "failure to consider the criteria would have been grounds for reversal." *RIAA II*, 176 F.3d at 534 (emphasis added). *See RIAA,* 662 F.2d at 9 (rate must be calculated to achieve statutory objectives). The *RIAA II* court concluded that "[i]n this case, the Librarian relied on the statutory objectives in making his decision, and thus his action is consistent with [*RIAA*]." 176 F.3d at 534.

24. In short, the D.C. Circuit has made clear that the task under section 801(b)(1) is not to emulate the rates that would be "negotiated in the marketplace between a willing buyer and a willing seller" as under section 114(f)(2)(B). A statutory rate "need not mirror a . . . marketplace rate . . . because it is a mechanism whereby Congress implements policy considerations which are not normally part of the calculus of a marketplace rate." 63 Fed. Reg. at 25409. Congress knows how to direct courts to find true market value or something approximating it, and surely could have done so under section 801(b)(1). *Cf. CSX Transportation, Inc. v. Georgia State Board of Equalization*, 128 S.Ct. 467 (2007) (reversing decision to deviate from statutory requirement to determine "true market value").

25. Repeated amendments to the Copyright Act, even adopting new ratesetting standards and processes, have kept the 801(b)(1) standard intact and confirm the foregoing approach. *See* Title 117 Technical Corrections, Pub. L. 105-80, 111 Stat. 1529 (1997) (no change to mechanical royalty rate setting standard); Digital Millennium Copyright Act, Pub. L. 105-304, 112 Stat. 2860 (1998) (same); Small Webcaster Settlement Act of 2002, Pub. L. 107-321, 116 Stat, 2780 (2002) (same); Copyright Royalty and Distribution Reform Act of 2004, Pub. L. 108-419, 118 Stat. 2341 (2004) (implementing wholesale changes to the rate setting process but not changing the standard to be applied in setting mechanical rates); Copyright Royalty Judges Program Technical Corrections Act, Pub. L. 109-303, 120 Stat. 1478 (2006) (amending certain processes carried out by the Copyright Royalty Judges, but not changing standard for mechanical royalty rate setting).

## III. THE RECORD EVIDENCE SUPPORTS DiMA'S PROPOSED RATES AND TERMS

26. The record evidence clearly supports DiMA's proposed rates and terms. Making musical works available requires sellers to sell and buyers to buy those works. *See* § 801(b)(1)(A) ("maximiz[ing] availability"). Given widespread access to pirated, free music, the price of music offerings must be low enough for sellers to attract buyers. *See* § 801(b)(1)(B) ("fair[ness] . . . under existing economic conditions"). In addition, buyers are attracted to innovative and ever-improving offerings, which require consistent investment and risk. *See* § 801(b)(1)(C) ("reflect[ing]" these roles). All of this puts pressure on margins, which in turn requires digital distributors to keep costs as low as possible. Imposing fixed penny rates in this industry – and effectively regulating prices at current levels – would impede expansion and kill nascent entry. *See* § 801(b)(1)(D).

the overall music market, and the digital music industry in particular. DiMA PFF §§ III(B); IV(B). Not only do these efforts benefit consumers, they expand sales and revenues for copyright owners as well. DiMA PFF § IV(B). But growth is still fragile. DiMA PFF § V. DiMA's proposed rates are the most ideally suited to maximize the availability of creative works to the public. DiMA PFF §§ VII; VIII(A); X. In particular, lower rates (not higher rates), and percentage of revenue rate structures (with true minima – not confiscatory minima that set unreasonable pricing floors) are the most sensible approach to growing the music market and ensuring maximum compensation to copyright owners. *Id.*

35. The Copyright Owners failed to show how maintaining the current penny rate structure and raising rates for digital music distributors will maximize the availability of creative works to the public. DiMA PFF § VII(B); VIII(B). Indeed, the Copyright Owners could not show that the number of new songs being written is any lower today compared to any point in time. DiMA PFF § VI. They could not show that their proposal to raise the cost of selling music digitally would do anything to stimulate additional sales of recorded music. DiMA PFF § VII(B). For a product whose demand is intensely price-sensitive – and whose supply cannot empirically be correlated to the mechanical royalty rate – the only logical response to prevailing marketplace conditions is to encourage innovation and lower costs so as to maximize revenue. DiMA PFF §§ III; V; VI; VII(A). Their proposal does the opposite.

36. For all of these reasons, achievement of the objective set forth in section 801(b)(1)(A) – maximizing the availability of creative works to the public – counsels in favor of a lower rate and a percentage of revenue, without confiscatory minima.

## B. AFFORDING THE COPYRIGHT OWNER A FAIR RETURN FOR HIS OR HER CREATIVE WORK AND THE COPYRIGHT USER A FAIR INCOME UNDER EXISTING ECONOMIC CONDITIONS

37. Section 801(b)(1)(B) requires the Court to set a rate that provides fair compensation to copyright owners and copyright users "under existing economic conditions." 17 U.S.C. § 801(b)(1)(B). Frequently, the debate with respect to the interpretation of this objective involves questions about what is "fair" to either side, which has no ready answer. Obviously, in an unregulated marketplace environment market prices are one indication of what is "fair." But Congress has regulated the market for making and distributing phonorecords to the public and there is no dispute about "existing economic conditions."

38. In brief, digital music piracy is rampant and pervasive, casting a shadow on every industry participant. DiMA PFF § III(A). According to the Supreme Court, the scope of digital piracy is "staggering." *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.*, 545 U.S. 913, 923 (2005). *See also id.* at 948 (describing the "overwhelming" tide of piracy) (Ginsburg, J., concurring). The implications are clear as well. Digital piracy "threatens copyright holders as never before, because every copy is identical to the original, copying is easy, and many people (especially the young) use file-sharing software to download copyrighted works." *Id.* at 928-29. Under these existing conditions, no party can claim and this Court cannot conclude that increasing royalty costs are required to ensure a "fair return."

39. Even the Register of Copyrights has recognized the difficulties attendant to relying on the mechanical license under existing economic conditions:

> Legal music services can combat piracy only if they can offer what the 'pirates' offer . . . . [R]ight now, illegitimate services clearly can offer something that consumers want, lots of music at little or no cost. They can do this because they

> offer people a means to obtain any music they please without obtaining the appropriate licenses. However, under the complex licensing scheme engendered by the present Section 115, legal music services must engage in numerous negotiations which result in time delays and increased transaction costs. In cases where they cannot succeed in obtaining all of the rights they need to make a musical composition available, the legal music services simply cannot offer that selection, thereby making them less attractive to the listening public than the pirates.

Peters 2005 Statement at 11-12.

40. In this regard, a critical insight of the Copyright Royalty Tribunal is that Section 801(b)(1)(B) "regulates the price of music" specifically with the objective of "permit[ting] any [licensee] to enter the market at will." 46 Fed. Reg. 10466, 10480. In applying this objective, the Tribunal expressly considered how it could set a rate that would continue to "permit entry into the music market by a potential copyright user." 46 Fed. Reg. 10466, 10480. In particular, the Tribunal concluded that entrants should be afforded "the opportunity to earn a fair income." 46 Fed. Reg. 10466, 10480. This makes sense because the purpose of setting regulated rates under section 801(b)(1)(B) is to lower entry barriers for music licensees. 63 Fed. Reg. at 25409. To meet this objective, the Court must provide access to music "at a price that [does] not hamper . . . growth." 63 Fed. Reg. at 25409 (emphasis supplied).

41. Without question, the sustained and continued entry of digital music providers is the most important bulwark against piracy. DiMA PFF §§ III(B); IV(C). *See also Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.*, 545 U.S. 913, 964 (2005) (describing the promise of technological innovation) (Breyer, J., concurring). Thus, it is entirely appropriate under this factor to set a rate that promotes and encourages entry by and continued growth of digital music services. *See* 46 Fed. Reg. 10466, 10480.

42. The record makes clear this is not a zero-sum problem. DiMA PFF § IV(B). Determining rates that will allow legitimate distributors to expand legitimate sales (and displace pirated distribution) will expand the return for all industry participants. DiMA PFF § III(B), IV(B). Costs and risks are high for digital music distributors. DiMA PFF § V. In particular, piracy places downward pressure on prices and upward pressure on costs for these companies. DiMA PFF § III(A). Evidence of a single successful or profitable digital music distributor or isolated examples of entry is not enough to achieve this objective. DiMA PFF § VIII(A)(4).

43. By contrast, establishing a rate unduly focused on providing greater compensation for any individual work sold, without considering its impact on sales and the influence of existing economic conditions, will result in lower income for everyone. DiMA PFF § VII(B); VIII(B). The Copyright Owners' proposal does not permit entry or lower entry barriers. DiMA PFF § V(C); VII(B); VIII(B). It is not designed to encourage growth. In fact, it is expressly intended to be set too high – as if adding transaction costs to an already complex marketplace could somehow be helpful. DiMA PFF § VIII(B)(6). *See also* 662 F.2d at 12 (rejecting "bargaining room" approach to ratesetting).

44. Finally, the Copyright Owners erroneously argue that a supposed connection between iTunes and iPods is an appropriate basis on which to set rates. DiMA PFF § VIII(A)(4). As an initial matter, none of the activities involved in the manufacture, sale, marketing or use of an iPod (or any playback device, for that matter) implicates the exclusive rights at issue in this proceeding. *See* 17 U.S.C. §§ 107, 115. Nor do the objectives in section 801(b)(1) apply to playback technology. Thus, whether

music is eventually played on a record player, tape deck, CD player, personal computer or MP3 player (or a new device that is heretofore unknown or in development) does not matter for purposes of ratesetting. DiMA PFF § III(B).

45. The Copyright Owners are not proposing (and the Court is not determining) just an "iPod" rate or just a rate applicable to Apple, nor could they under the law. Apple is not the only digital distributor to which the rates set by the Court will apply, and not all digital distributors are also engaged in the development, manufacture and/or sale of playback devices (although other current and future digital distributors may be engaged in various other businesses related to, but separate from, their digital distribution businesses). DiMA PFF §§ I; V(C); VIII(A)(4). It is, therefore, wholly inappropriate to focus on one company's separate line of business (and one brand of playback device) in determining appropriate mechanical rates.

46. Even if such an inquiry were proper – which is not the case – the evidence in the record does not support any findings on this topic. The Copyright Owners utterly failed to provide any factual foundation for their argument, pursued no documents in discovery, and proffered nothing more than speculation by a handful of their witnesses. There is certainly insufficient support for a conclusion that the only promotional effect is that of musical works on the sale of a particular playback device. To the contrary, the evidence showed that digital playback devices can also have a positive impact on the legitimate sale of music online. DiMA PFF § VIII(A)(4). And taxing device sales will discourage entry and innovation in this marketplace – precisely the opposite of what the statute intends.

47. In any event, to the extent that Congress may have separately identified specific circumstances in which copyright assessments should be imposed on certain music playback devices, it has done so expressly and not under section 115. *See* Audio Home Recording Act of 1992, Pub. L. No. 102-563, 106 Stat. 4237 (1992), codified at 17 U.S.C. § 1001 *et seq.* Absent any statutory support here, proposing to set rates with reference to potential revenues generated by the sale of music playback devices – let alone a particular brand of music playback device – is entirely unwarranted.

48. A principled inquiry based on the Copyright Owner's argument would also require consideration of a range of other issues. For example, the extent to which songwriter income from performance royalties, tour revenue, synch rights, ringtones, souvenir items and other revenue streams affect the availability of music online might require a reduction in the mechanical royalty rate. The Court would then have to consider setting a lower mechanical royalty for singer-songwriters and other "vertically integrated" songwriters successfully employed in other lines of business, or setting different rates for different songwriters depending on their success or lack thereof in related fields of endeavor. Fundamentally, these positions are as equally flawed and unfair as the argument to consider revenue from the sale of iPods (or any playback device) in setting a rate that will apply to the sale of permanent downloads.

49. For all of these reasons, the objective set forth in section 801(b)(1)(B) – affording fair return and fair income under existing economic conditions – also counsels in favor of a lower rate and a percentage of revenue, without confiscatory minima.

### C. REFLECTING THE RELATIVE ROLES OF THE COPYRIGHT OWNER AND THE COPYRIGHT USER IN THE PRODUCT MADE AVAILABLE TO THE PUBLIC

50. Section 801(b)(1)(C) requires the Court to set a rate that reflects the relative roles of the copyright owner and copyright user over a range of considerations involved in making digital music available to the public. 17 U.S.C. § 801(b)(1)(C). No one disputes the importance of songwriters to the creative process. *See* 46 Fed. Reg. 10466, 10481. Songwriters may also find it useful to collaborate with publishers. *Id.* But after a song is written much remains to be done to make a product "available to the public." To this end, the producer of the sound recording makes "unique and distinctive contributions." 46 Fed. Reg. 10466, 10481.

51. However, the focus of inquiry under this statutory objective is the end "product [made] available to the public" as enabled by the license. 17 U.S.C. § 801(b)(1)(C). The Copyright Royalty Tribunal recognized this when it considered contributions to the end "product" at issue in 1981 the last time a rate for the mechanical license was calculated to reflect the relative roles of the parties. *See* 46 Fed. Reg. 10466, 10480-10481. Subsequent applications of this particular statutory objective have followed a consistent approach. *See* 63 Fed. Reg. 25394, 25407-25408 (affirming determination to consider contributions to the music offering); 73 Fed. Reg. 4080, 4096 (considering contributions to music channels offered by licensees).

52. Digital music distributors play the most important role relative to "technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communications." 17 U.S.C. § 801(b)(1)(C). These contributions should be reflected in a lower mechanical rate. Moreover, in a digital music market that is undergoing rapid change, the "relative roles"

of copyright owners and users could change in unforeseen ways. Accordingly, the Court should adopt a percentage-of-revenue rate structure – as opposed to a penny rate – which will continue to reflect these relative roles in the future. DiMA PFF § VII.

53. With respect to the first criteria, the creative contributions of digital music distributors support a lower rate. DiMA members offer millions of songs in comprehensive catalogs through simple-to-use and elegant web sites that allow for easy browsing, as well as powerful search and cataloging tools for more intense exploration (and eventual royalty-bearing consumption) of digital music. DiMA PFF § IV(A). To complement these features, digital music distributors provide compelling editorial content such as music reviews, as well as information about artists and composers designed to create a deeper experience for the user. *Id.* The Copyright Owners offer nothing additional with respect to any of these features of the product made available to the public. DiMA PFF § VIII(B).

54. The relative technological contributions of the parties also point decisively towards a lower rate. Digital music distributors contribute the only technology used to provide their services to the public. DiMA PFF §§ IV(A); V(B). This includes servers providing massive storage capabilities, bandwidth and transmission facilities, and advanced software to manage customer accounts and rapidly evolving customer hardware – as well as to ensure compliance with complex licensing requirements. DiMA PFF § V(B). The Copyright Owners themselves concede the critical importance of technology and technological innovation, to which they contribute nothing and which has done and will do more to increase the returns from their works than anything that could

be accomplished by increasing the statutory mechanical royalty rate. DiMA PFF §§ III(B); IV(B).

55. Massive capital investment on the part of digital music distributors to make all of this possible further supports the lowest possible rate. DiMA PFF § V(B). The Copyright Owners, by contrast, have not made any investments targeted at encouraging digital distribution. DiMA PFF § VIII(B). Moreover, the fixed and variable costs of providing digital music offerings are substantial and also support the lowest possible rate. DiMA PFF §§ V(B); V(C). Copyright Owners incur no additional costs to provide these services. DiMA PFF § VIII(B). There is no evidence that any of these costs or investments can be recovered from or transferred to artists and songwriters. *See* 46 Fed. Reg. 10466, 10480. And these costs and investments will continue to be required during the license period. DiMA PFF § V(C). *See also* 73 Fed. Reg. 4080, 4096 (considering the need for continued investments). Therefore, these factors with respect to the costs and investments incurred by digital music distributors weigh heavily towards the lowest possible rate that reflects the relative contributions toward making the product available to the public.

56. Importantly, the costs incurred by digital music services – which they must continue to incur during the license period – appropriately include "marketing and promot[ing]" the services and "advertising campaigns" to bring them to the attention of the public. 46 Fed. Reg. 10466, 10480-10481. *See* DiMA PFF §§ III(A)(2); V(B)(6); V(C). In a marketplace where the most widely available alternative to the offering is free, such efforts are critical. *Id.* Moreover, these expenditures are necessary to educate

the consuming public about new technology and new ways of paying for music that are not yet mainstream. *Id.*

57. The overwhelming evidence of piracy and the brutally competitive nature of the marketplace are well documented in the record. DiMA PFF § III(A); V; VII. There is no question that digital music companies incur substantial risks to enter the marketplace and provide their offerings. DiMA PFF § V(B). Competing in this marketplace requires enormous sunk investments. DiMA PFF §§ III(B); V(B). Margins are consistently low. DiMA PFF §§ V; VIII(B). Even as some succeed, many digital music distributors have been forced out of the industry and others have had operating losses since their inceptions. DiMA PFF § V(C).

58. Finally, there can be no question that digital music companies are making significant contributions to the opening of "new markets" for creative expression and media for their communication. *See* 17 U.S.C. § 801(b)(1)(C). This consideration essentially defines the role that DiMA members play. DiMA PFF §§ III(B); IV; V. Before there were legitimate digital music services, there was no music on the Internet except for rampant piracy. DiMA PFF § III(A). Into this environment, DiMA member companies have developed an entirely new industry and educated consumers about entirely new ways to pay for music. DiMA PFF § III(B). DiMA member companies expose more consumers to more music in a more challenging marketplace environment and offer more benefits to copyright owners, undoubtedly "opening new markets for creative expression and media for their communication." 17 U.S.C. § 801(b)(1)(C).

59. The Copyright Owners have incurred no additional risks in licensing digital distribution, since their products were already available through pirate Internet

sites. DiMA PFF § VIII(B). Especially considering the overall purpose of the statutory license to encourage and promote precisely this sort of entry, the statutory objective weighs decisively and incontrovertibly in favor of setting the lowest possible rate.

60. For all of these reasons, achievement of the objectives set forth in section 801(b)(1)(C) – reflecting the relative roles of the copyright owner and the copyright user for specific contributions to the product made available to the public – also counsels in favor of a lower rate and a percentage of revenue, without confiscatory minima.

### D. MINIMIZING ANY DISRUPTIVE IMPACT ON THE STRUCTURE OF THE INDUSTRIES INVOLVED AND ON PREVAILING INDUSTRY PRACTICES

61. Section 801(b)(1)(D) requires the Court to set a rate that minimizes the disruptive impact on industry structure and prevailing practices. 17 U.S.C. § 801(b)(1)(D). Of course, due to rampant Internet piracy the industries involved here are undergoing massive disruption already. DiMA PFF §§ III(A); V. In that regard, the rate and rate structure must be calculated with sensitivity to the state of the marketplace – as well as the efforts being made to enter and compete in the marketplace. *See supra.*

62. To be perfectly clear: under section 801(b)(1)(D), the fact that under existing market conditions licensees may be "struggling to create a sustainable subscriber base" or might be unable to "show[] a profit" – or even "[do] not expect to reach profitability in the near future" – is a reason to set a rate as low as possible. 63 Fed. Reg. 25394, 25410 (setting rate on the low side and eschewing a minimum fee so as to "not harm the industry at this critical point in its development."). This stands in sharp contrast to the setting of rates and terms under the "willing buyer/willing seller standard," which the Court has interpreted to discourage "policy decision[s]" deviating from a marketplace outcome and protecting inefficient business models. *Digital Performance Right in Sound*

*Recordings and Ephemeral Recordings; Final Rule*, 72 Fed. Reg. 24084, 24088 n.8 (May 1, 2007) (applying 17 U.S.C. § 114(f)(2)(b)). Whether it is permissible under other standards or not, the plain language of Section 801(b)(1) expressly requires such a "policy decision."

63. As a result, in calculating a rate to minimize disruption the Court should at a minimum avoid rates and rate structures that would have an adverse impact on digital music distributors' ability to "attain[] a sufficient subscriber base" or "generate[] sufficient revenues to reach consistent Earnings Before Interest, Taxes, Depreciation and Amortization profitability or positive free cash flow." 73 Fed. Reg. 4080, 4097. In addition, the Court should at the very least avoid rates and rate structures that would have a negative impact on the ability of a licensee "to successfully undertake [necessary] investments planned for the license period . . . [and] disrupt[] current consumer service." 73 Fed. Reg. 4080, 4097.

64. The fact that the penny rate has been in place for a long time for physical product (and even since the beginning of the nascent permanent download market) is irrelevant. The Copyright Owners concede that the digital marketplace has barely gotten off the ground. DiMA PFF § V(A). The statute is focused on lowering entry barriers, and this counsels strongly against adopting the high rates and minimum fees proposed by the Copyright Owners. DiMA PFF § VIII(B). Importantly, whether or not the financial state of an industry may be "difficult to ascertain" is not justification to ignore the potential for disruption from the imposition of an unduly high rate or confiscatory minima. *See* 63 Fed. Reg. 25394, 25410 (licensee industry consisting of three identified participants).

65. The foregoing concerns are elevated in this proceeding because the outcome will apply to more than a closed set of participants. *Compare* 73 Fed. Reg. 4080 at n.3 (eligibility for the statutory license strictly proscribed). To that end, in considering the statutory mandate with respect to ratesetting for an entire industry consisting of more than a limited number of participants, the Copyright Royalty Tribunal proceeded very cautiously before increasing the mechanical royalty rate in 1981.

66. First, the Tribunal relied on a comprehensive study of the record industry finding that revenues of record companies had been increasing substantially while the revenue from the mechanical royalty rate had declined. 46 Fed. Reg. 10466, 10476, 10481. As it made clear, "the recorded music industry . . . experienced significant growth" in the years prior to 1981 and their "fortunes [had] been enhanced." 46 Fed. Reg. 10466, 10483. Second, the Tribunal concluded that record labels had been able to profitably absorb cost increases and would be able to absorb additional cost increases and even operate at higher profit margins even after absorbing higher royalty rates. 46 Fed. Reg. 10466, 10484. Finally, the Tribunal pointed to the absence of "any probative evidence" of disruption likely from the rates as increased. 46 Fed. Reg. 10466, 10481 (emphasis supplied). Indeed, the Tribunal found the "evidence" of disruption consisted of no more than flimsy speculation and pessimism. 46 Fed. Reg. 10466, 10482.

67. In this regard, the record evidence in this proceeding is diametrically to the contrary – and supports the rates and terms proposed by DiMA. DiMA PFF §§ VII; VIII. The rates proposed by the Copyright Owners would halt innovation in its tracks. Even if it did not stop digital distribution entirely, it would stifle further entry, contrary to the express statutory objectives.

68. Moreover, revenue should be defined so as to capture use of the musical works. DiMA PFF § VII(A). DiMA's proposed definition is consistent with the Court's decision in *Preexisting Subscription Services and Satellite Digital Audio Radio Services*, 73 Fed. Reg. 4080. DiMA PFF § VIII(A). Not only would an overly expansive revenue definition be massively disruptive, but there is no evidentiary support for it. *Id.* at 4087 (criticizing SoundExchange proposal and adopting proposal that "more unambiguously relates the fee to the value of the [rights] at issue . . . .").

69. Tellingly, with respect to the potential for disruption, the Copyright Owners inappropriately focus on the experience of a single company (Apple) and a single business model (iTunes) as a proxy for setting rates for an entire industry. DiMA PFF § VIII(A)(4). But the success of a single company is no better indication of the health of an entire industry than the success of a single songwriter. Either example would be hardly probative as to determining whether a rate or rate structure would avoid disruption. The record demonstrates that profitability is generally elusive and that increasing costs is a sure way to hinder additional marketplace entry. DiMA PFF § V. The Copyright Owners also argue that a percentage rate structure itself is disruptive. DiMA PFF § VII. But they use percentage rates in markets around the world already, and many have conceded that a percentage rate would make sense for digital businesses. *Id.* *See also* 46 Fed. Reg. 10466, 10485 (Copyright Royalty Tribunal recognized importance of responding to changes in the retail price of music).

70. DiMA recognizes that minimum fees have previously been found inconsistent with the statutory objectives. *See* 63 Fed. Reg. 25394, 25410 n. 34. The record labels' concerns in that case that revenues could be miscalculated or that

marketing strategies could undercut the fee were rejected where the evidence showed the licensees needed pricing flexibility to meet competitive market demands. *Id.* Indeed, there is no basis to conclude minimum fees are required under section 801(b)(1), since Congress knows how to require them and has done so expressly in other circumstances. *See, e.g.*, 17 U.S.C. § 112(e)(4). Any proposal for a minimum fee must demonstrably achieve the statutory objectives, particularly sections 801(b)(1)(B) and (D). Such a proposal must be calibrated to provide continued flexibility for pricing in a marketplace undergoing massive transformation. DiMA PFF §§ VII(A)(8); VIII(A); X. Just like higher penny rates, high "minima" would not achieve the statutory objective. *Id.* That is why minimum fees, if adopted, should be set to provide downside protection to copyright owners but not as an alternative form of royalty calculation.

71. Finally, it is important to ensure that the rates and terms adopted here cover all copies made in the process of transmitting licensed digital phonorecord deliveries to consumers. DiMA PFF § VIII(A)(3). The Copyright Owners' proposal does not do so, and it would be massively disruptive if adopted.

72. For all of these reasons, achievement of the objective set forth in section 801(b)(1)(D) – minimizing any disruptive impact on the structure of the industries and on generally prevailing practices – also counsels in favor of a lower rate and a percentage of revenue, without confiscatory minima.

### E. REFERENCE POINTS AND BENCHMARKS

73. The statutory objectives help to determine a "range of reasonable royalty rates" along with various potential benchmarks from which the Court is free to make a judgment about how best to proceed. *RIAA*, 662 F.2d at 9 (noting mandate to reconcile the objectives, regardless of how much weight each is given). *See also* 63 Fed. Reg.

25394, 25404 (benchmarks a useful starting point "in conjunction with record evidence"), *aff'd* 176 F.3d 528. The only prior application of the statutory objectives to determine rates for the mechanical license – affirmed by the D.C. Circuit – relied on benchmarks to help evaluate the parties' proposals and calculate a rate. Specifically, the Copyright Royalty Tribunal examined mechanical rates from other countries as "a benchmark against which to judge" the existing mechanical rate. 46 Fed. Reg. 10466, 10484. *See also id.* at 10483 ("We find that the foreign experience is relevant – because it provides one measure of whether copyright owners in the United States are being afforded a fair return."). The Tribunal also considered evidence of other statutory license rates as a "benchmark of reasonableness" if not as binding precedent. 46 Fed. Reg. 10466, 10486.

74. While licenses for closely comparable services and rights can provide useful insights, there is nothing in the statute or any judicial decision interpreting it that requires beginning specifically and exclusively with perfect marketplace benchmarks. *Compare* 73 Fed. Reg. 4080, 4088 (noting "apparent general agreement [about] beginning with a relatively comparable marketplace benchmark"). In setting rates under section 114(f)(1)(B), the Act clearly gives the Court guidance in addition to the objectives under section 801(b)(1) to consider "rates and terms for comparable types of subscription . . . services . . . ." without any other limitation. 17 U.S.C. § 114(f)(1)(B). *Accord* 73 Fed. Reg. 4080, 4084 (section 114(f)(1)(B) "affords . . . discretion to consider the relevance and probative value" of such marketplace agreements).

75. Under section 115, however, Congress did not provide similar guidance, indicating the primacy of the section 801(b)(1) objectives to the current proceeding. *See* 17 U.S.C. § 115(c)(3)(D) (Court "may consider" rates and terms solely for voluntarily

negotiated mechanical licenses). Moreover, nothing in the statute itself indicates that the Court must start with a particular benchmark and use the statutory objectives to adjust it. To the contrary, the statute provides without equivocation -- and without reference to benchmarks -- that rates must be calculated to achieve the four objectives. 17 U.S.C. § 801(b)(1). *See RIAA II*, 176 F.3d at 533 (affirming this approach).

76. Clearly, benchmarks for present purposes need not be limited to "market" outcomes, which by definition exclude evidence that might otherwise help to achieve the statutory objectives. *See* 63 Fed. Reg. 25394, 25406 (Court "free to find that a rate on the low end [of a range] was reasonable so long as that rate fell within 'zone,' and the 'zone' was calculated to achieve the statutory objectives."). In this regard, the parties have offered a wide range of potential comparators and benchmarks for the Court's evaluation. DiMA PFF § IX.

77. The most useful benchmark in the record is the license agreement entered in the United Kingdom for 8% of retail revenue plus applicable minima, which includes the reproduction, distribution and public performance of musical works by digital music services. DiMA PFF § IX(B). It is a marketplace agreement and clearly comparable on the most important dimensions in terms of the rights at issue, the parties, and the marketplace, as well as being roughly contemporaneous to this proceeding. *Id.* "'[C]omparability' is a key issue in gauging the relevance of any proffered benchmark." 73 Fed. Reg. 4080, 4088. Of course, the license fee from this agreement covers more than the rights at issue in this proceeding. DiMA PFF § IX(B). Moreover, the agreement settled litigation in the United Kingdom in which licensees have the burden of proof to show the license rates are unreasonable. *See In the Matter of a Reference Under the*

*Copyright, Designs and Patents Act 1988* [2007], CT84-90/05, at ¶ 46. For these reasons, the agreement represents an upper bound estimate for a reasonable rate in this proceeding. DiMA PFF § IX(B).

78. In addition to this agreement, the 1981 decision of the Copyright Royalty Tribunal provides additional important information for the Court. DiMA PFF § IX(D). Just as "foreign experience is relevant -- because it provides one measure of whether copyright owners . . . are being afforded a fair return," so too does the 1981 outcome "provide some guidance for assessing the proposed rate." *See* 63 Fed. Reg. 25394, 25404 (relying on license agreement for non-existent rights). Specifically, it is relevant for having established a rate that subsequently became embedded in industry expectations through repeated adjustment for inflation and re-adoption through settlement. DiMA PFF § IX(D). Although there is no precise way to express the outcome of the 1981 decision as an exact percentage of retail revenue, at roughly 5% of retail revenue it is toward the lower end of the range of comparable benchmarks in the record and generally consistent with the U.K. rate. *Id.*

79. As explained above, achieving the statutory objectives requires setting a percentage of revenue rate structure with lower rates and non-disruptive minima. In terms of comparables, this is best reflected by the license from the United Kingdom, adjusted down to account for the additional rights in that agreement. Information from the 1981 decision and contemporaneous international rates in the same range, confirms the reasonableness of this outcome. DiMA PFF § IX. All of these guideposts and the statutory objectives establish a range between 4% and 6% of the licensee's retail revenue. DiMA PFF §§ IX; X.

80. On the other hand, none of the benchmarks proposed by the Copyright Owners is a suitable comparator for permanent downloads, and none provides support or precedent for the high rates they propose. DiMA PFF § IX(E). Indeed, the Copyright Owners admitted that their request is higher than the rates paid for mechanical rights in virtually every other country. DiMA PFF § IX(C). The other benchmarks the Copyright Owners offer were all calculated to support the highest possible rate rather than to provide useful information as to how to achieve the statutory objectives. DiMA PFF § IX(E). This is not surprising, as the Copyright Owner's chief economic expert made no effort to hide his discomfort with regulating rates and instead sought to justify the highest possible outcome. DiMA PFF § VIII(B)(6).

81. In addition to the foregoing, although more for purposes of seeking parity as part of the "pool" of royalties paid to content owners in general, the Copyright Owners pointed to fees paid by digital music services for sound recording licenses. DiMA PFF §§ VIII(B)(6); IX(E). As the Court is aware, payments for sound recording rights are "multiple times the amounts paid for musical works rights in most digital markets." 73 Fed. Reg. 4080, 4089. Such licenses do not involve comparable rights and can hardly serve as useful benchmarks or estimates of how to achieve the statutory objectives. Moreover, those licenses reflect a considerable bargaining disadvantage on the part of the licensees. DiMA PFF § IX(E). The purpose of the statutory license is to encourage entry and promote the availability of copyrighted works; that is, to regulate precisely this sort of imbalance. *See supra.* The Copyright Owners apparently seek to point to these payments in an aspirational manner. But the amount paid for one set of rights "serves no practical purpose" in determining what should be paid for another set of rights where "no

clear nexus exists between the values . . . ." 63 Fed. Reg. 25394, 25405. Here, the Copyright Owners failed to establish any such nexus.

**F. SUMMARY**

82. The rates and terms proposed by DiMA most closely achieve the statutory objectives in light of the entire record. A percentage rate structure is most suitable to ensure entry and growth of digital music services, which will provide returns to copyright owners. DiMA PFF §§ VII(A);VIII(A). The revenue definition DiMA proposes is carefully tailored so as not to overly regulate or create undue transactions costs. The rate level DiMA proposes will ensure fair income and fair return under existing economic conditions, reflecting the massive investments that are required to grow the industry and the overwhelming importance of encouraging technological innovation to do so. DiMA PFF § VIII(A). Carefully setting minimum fees so as to not discourage entry or prevent competitive pricing will minimize disruption. DiMA PFF §§ VII(A);VIII(A). *See also* 46 Fed. Reg. 10466, 10485-10486 (reviewing entire record to determine royalty amount).

83. The rates and terms proposed by the Copyright Owners do not achieve the statutory objectives. DiMA PFF § VIII(B). Failing to make absolutely clear that payment for the license includes all copies necessary to deliver the works to consumers renders the license useless. Increasing rates at a time of falling prices for recorded music is contrary to law and precedent. Raising the costs of doing business will make it harder for new entrants to enter and for existing services to compete. DiMA PFF §§ V; VII; VIII. Refusing to recognize marketplace reality and sticking with a penny rate structure will prevent competitive pricing and innovative offerings – precisely the opposite effect as intended by the statutory objectives. DiMA PFF § VII. For all of these reasons, the Copyright Owners do not offer any basis for achieving the statutory objectives.

## IV. TERMS

84. The Copyright Act plainly authorizes the Court to set terms for the mechanical license. *See* 17 U.S.C. § 115(c)(3)(C) ("[p]roceedings under chapter 8 shall determine reasonable rates and terms of royalty payments"); § 801(b) ("the Copyright Royalty Judges shall . . . make determinations and adjustments of reasonable terms and rates of royalty payments as provided in section[] . . . 115."); § 802(f)(1)(A)(i) (the Copyright Royalty Judges shall "mak[e] determinations . . . of copyright royalty rates and terms.") (emphasis supplied). Section 115(c)(5) of the Copyright Act also charges the Register of Copyrights with prescribing generally applicable regulations regarding the making of payments and the certification of accounts under the statutory license. *See* 17 U.S.C. § 115(c)(5) (referring to "requirements that the Register of Copyrights shall prescribe by regulation.").

85. To the extent that the authority of the Register and the Court overlap, their concurrent jurisdiction should be reconciled to give effect to the statute. *See FTC v. Ken Roberts Co.*, 276 F.3d 583, 593 (D.C. Cir. 2001) ("Because we live in 'an age of overlapping and concurring regulatory jurisdiction' . . . a court must proceed with the utmost caution before concluding that one agency may not regulate merely because another may.") (internal citations and quotations omitted); *see also Pennsylvania v. ICC*, 561 F.2d 278, 292 (D.C. Cir. 1977) ("It is well established that when two regulatory systems are applicable to a certain subject matter, they are to be reconciled and, to the extent possible, both given effect."). *Cf. Massachusetts v. EPA*, 127 S. Ct. 1438, 1462 (U.S. 2007) ("[T]here is no reason to think . . . two agencies cannot both administer their obligations and yet avoid inconsistency.").

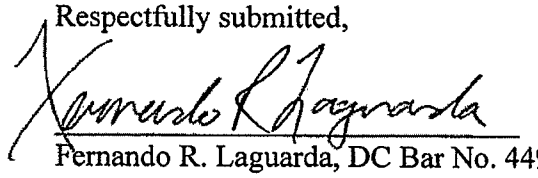
86. Although the Act does not define the precise meaning of "terms" under the Section 115 compulsory license, the Senate Committee on the Judiciary explained in connection with the enactment of the Digital Performance Right in Sound Recordings Act of 1995, Pub. L. 104-39, 109 Stat. 336 (1995), that "terms" include "such details as how payments are to be made, when, and other accounting matters," as well as other regulations provisions required for the "new digital transmission environment." S. Rep. No. 104-128, at 40 (1995).

87. The Court is therefore authorized to adopt DiMA's proposed terms, which identify the revenue against which the license rate should be applied, define the licensed work (*e.g.*, "permanent digital phonorecord delivery"), and set forth the scope of activities covered by the statutory license. Without such definitional "terms" a licensee could not be certain of whether the license is necessary or sufficient to engage in the making and distribution of digital phonorecord deliveries. *See* S. Rep. No. 104-128, at 40 (1995) (terms should ensure the license is "applicable to the new digital transmission environment").

## CONCLUSION

88. For the reasons set forth herein and in the accompanying Proposed Findings of Fact, the Court should adopt DiMA's Proposed Rates and Terms.

Respectfully submitted,



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July 2, 2008

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## EXHIBIT A:

## SECOND AMENDED PROPOSED RATES AND TERMS OF DiMA

**Add the following to Chapter III of title 37, Code of Federal Regulations (tentatively numbered part 380 for purposes of reference):**

PART 380 – RATES AND TERMS UNDER COMPULSORY LICENSE FOR MAKING AND DISTRIBUTING A DIGITAL PHONORECORD DELIVERY

Sec.

380.1 General.

380.2 Definitions.

380.3 Royalty rates.

380.4 Scope of statutory license.

### § 380.1 General.

This part 380 establishes rates and terms of royalty payments for all copies made in the course of making and distributing phonorecords, including by means of digital phonorecord delivery, in accordance with the provisions of 17 U.S.C. 115.

### § 380.2 Definitions.

(a)(1) *Applicable receipts* means that portion of the money received by the licensee, or licensee's carrier(s), from the provision of a digital phonorecord delivery that shall be comprised of the following:

(i) revenue recognized by the licensee from residents of the United States in consideration for the digital phonorecord delivery in accordance with the provisions of 17 U.S.C. 115; and

(ii) the licensee's advertising revenues attributable to third party advertising "in download", being advertising placed immediately at the start, end or during the actual delivery of a digital phonorecord, less advertising agency and sales commissions.

*Note: Notwithstanding (i) and (ii), above, the licensee may pro-rate or allocate revenue on the basis of total usage of digital phonorecord deliveries of sound recordings or on any other reasonable basis that fairly and accurately reflects the revenues attributable to particular uses. For example, if revenue is received for a bundle or package, the licensee may allocate revenues on the basis of usage (if DPDs comprise half of total usage, then half of all revenues are attributed to them).*

(2) Applicable receipts shall include such payments as set forth in paragraph (a) of this section to which the licensee, or licensee's carrier, is entitled but which are paid to a parent, majority-owned subsidiary or division of the licensee.

(3) Applicable receipts shall exclude:

(i) revenues attributable to the sale and/or license of equipment and/or technology, including bandwidth, including but not limited to sales of devices that receive or perform the licensee's digital phonorecord deliveries and any taxes, shipping and handling fees therefore;

(ii) royalties paid to the licensee for intellectual property rights;

(iii) sales and use taxes, shipping and handling, credit card and fulfillment service fees paid to third parties;

(iv) bad debt expense; and

(v) advertising revenues other than those set forth in paragraph (a)(1)(ii) of this section.

(b) *Digital phonorecord delivery* means a digital phonorecord delivery as defined in 17 U.S.C. 115(d).

(c) *Permanent digital phonorecord delivery* means a digital phonorecord delivery that is distributed in the form of a download that may be retained and played on a permanent basis.

(d) *Licensee* means a person or entity that has obtained a compulsory license under 17 U.S.C. 115 and the implementing regulations therefore to make and distribute phonorecords, including by means of digital phonorecord delivery.

(e) *Licensee's carriers* means the persons or entities, if any, authorized by Licensee to distribute digital phonorecord deliveries to the public.

(f) *Licensed work* means the nondramatic musical work embodied or intended to be embodied in a digital phonorecord delivery made under the compulsory license.

**§380.3 Royalty Rates.**

(a) For a permanent digital phonorecord delivery, the royalty rate payable shall be the greater of (i) 6% of applicable receipts or (ii) 4.8 cents per track for single tracks or 3.3 cents per track for tracks sold as part of a single transaction including more than a single track ("bundles").

(b) In any case in which royalties must be allocated to specific musical works under subsection (a), each unique musical work's share shall be determined on a pro rata basis.

(c) In any future proceeding under 17 U.S.C. 115(c)(3)(C) or (D), the royalty rates payable for a compulsory license for any digital phonorecord deliveries shall be established de novo, and no precedential effect shall be given to the royalty rate payable under this paragraph for any period prior to the period as to which the royalty rates are to be established in such future proceeding.

**§380.4 Scope of statutory license.**

A compulsory license under 17 U.S.C. 115 extends to, and includes full payment for, all reproductions necessary to engage in activities covered by the license, including but not limited to:

(a) the making of reproductions by and for end users;

(b) all reproductions made in the normal course of engaging in such activities, including but not limited to masters, reproductions on servers, cached, network, and buffer reproductions.

## CERTIFICATE OF SERVICE

I hereby certify that on this 2d day of July 2008, I caused a true and correct copy of the foregoing "Proposed Conclusions of Law of the Digital Media Association; AOL, LLC; Apple, Inc.; MediaNet Digital, Inc.; and RealNetworks, Inc." to be served by email and overnight mail on the following:

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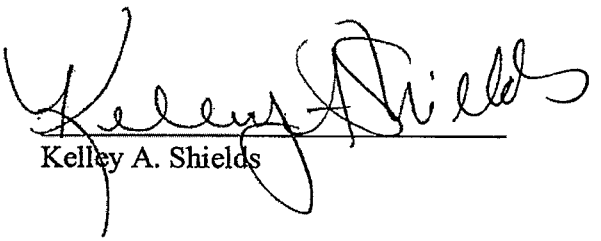

Kelley A. Shields